

Message Text

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PAGE 01 OTTAWA 01264 01 OF 02 040143Z
ACTION EUR-12

INFO OCT-01 IO-13 ISO-00 AID-05 CIAE-00 COME-00 EB-08
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SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04 CEA-01
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P 040120Z MAR 77
FM AMEMBASSY OTTAWA
TO SECSTATE WASHDC PRIORITY 2662
INFO USDEL MTN GENEVA
USMISSION GENEVA
USMISSION OECD PARIS
AMCONSUL MONTREAL
ALL OTHER CANADIAN CONSULATES POUCH

LIMITED OFFICIAL USE SECTION 01 OF 02 OTTAWA 01264

PASS TREASURY

E.O. 11652: N/A
TAGS: PFOR, ETRD, ECON, CA
SUBJECT: FINMIN MACDONALD'S WASHINGTON MEETING WITH
TREASURY SECRETARY BLUMENTHAL, MARCH 8

1. SUMMARY: ECON COUNSELOR DISCUSSED UPCOMING VISIT OF
FINMIN MACDONALD TO WASHINGTON WITH DEPMIN SHOYAMA AND
OTHER FINANCE OFFICIALS. THEY THOUGHT MACDONALD WOULD
CONCENTRATE ON INTERNATIONAL ECONOMY IN HIS TALKS WITH
TREASURY SECRETARY BLUMENTHAL, ALTHOUGH MTN, BILATERAL
ENERGY MATTERS, TAX TREATY, NEW U.S. TAX LAWS REGARDING
CONVENTIONS, ECONOMIC OUTLOOK FOR BOTH COUNTRIES AND
IFI'S WOULD BE COVERED. SHOYAMA ALSO GAVE INDICATION
OF FINANCE THINKING ON MACDONALD'S SPRING BUDGET AND
ENDING CONTROLS. END SUMMARY.

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PAGE 02 OTTAWA 01264 01 OF 02 040143Z

2. ON MARCH 3 ECON COUNSELOR DISCUSSED WITH FINANCE
DEPUTY MINISTER SHOYAMA AND OTHER FINANCE OFFICIALS
FINMIN MACDONALD'S VISIT TO WASHINGTON ON MARCH 8 AND
HIS MEETING WITH SECRETARY BLUMENTHAL. CONSENSUS ON
CANADIAN SIDE WAS THAT MACDONALD WISHED CONCENTRATE ON
WORLD ECONOMIC SITUATION, OBTAIN USG VIEWS ON PROSPECTS
FOR U.S. ECONOMIC GROWTH AND INFLATION, AND GET LATEST

USG POSITIONS ON VARIOUS INTERNATIONAL ECONOMIC ISSUES.

3. INITIAL DISCUSSION BEGAN WITH ASSISTANT DEPUTY MINISTER ROBERT JOYCE, INTERNATIONAL TRADE AND FINANCE BRANCH, AND ASSISTANT DEPUTY MINISTER M.A. COHEN, TAX POLICY BRANCH, AND SHOYAMA LATER JOINED MEETING. BECAUSE OF THE TWO ADM'S SPECIFIC INTERESTS, DISCUSSION BEGAN WITH MTN AND TAX ISSUES MACDONALD WOULD RAISE.

4. ACCORDING TO JOYCE, MACDONALD WANTS TO HEAR U.S. VIEWS ON TIMETABLE FOR MTN. HE HOPES U.S. SHARES CANADIAN VIEWS (A) THAT "BROADER PACKAGE" IS DESIRABLE RATHER THAN QUICK WRAPUP WITH MORE LIMITED AGREEMENT AS FRENCH ARE ADVOCATING AND (B) THAT IT WILL NOT BE A GREAT CALAMITY IF NEGOTIATIONS MUST BE CONTINUED BEYOND END OF 1977 TO ACHIEVE OBJECTIVE. JOYCE DID NOT EXPECT THAT MACDONALD/BLUMENTHAL DISCUSSION WOULD GET INTO DETAILS OF SPECIFIC TRADE ISSUES, BUT HE SUGGESTED MACDONALD MAY ASK FOR U.S. REACTION TO VALUATION PROPOSALS FLOATED BY EC WHICH WOULD REQUIRE SUBSTANTIAL CHANGES IN U.S. AND CANADIAN SYSTEMS AND MAY TOUCH ON CANADIAN CONCERN ABOUT DISCUSSION OF EXPORT RESTRICTIONS AND ESPECIALLY EXPORT TAXES IN GATT FRAMEWORK GROUP.

5. JOYCE SAID THAT, AS AN ADDITIONAL ITEM NOT ON PREVIOUSLY-PROPOSED AGENDA, MACDONALD WILL PROBABLY RAISE GENTLEMEN'S AGREEMENT ON EXPORT CREDITS. IN SEPARATE CONVERSATION, BOB SHOWMAN WHO IS FINANCE DEPARTMENT'S EXPERT ON THIS SUBJECT EXPLAINED THAT MACDONALD'S INTENTION WOULD BE TO PROPOSE TO SECRETARY BLUMENTHAL LIMITED OFFICIAL USE

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PAGE 03 OTTAWA 01264 01 OF 02 040143Z

THAT U.S. AND CANADA TAKE A COMMON LINE WITH REGARD TO EXTENSION OF THE AGREEMENT FOR ANOTHER YEAR, BRINGING IT INTO THE OECD FRAMEWORK AND STRENGTHENING IT BY REVISING LIMITS TO MORE COMMERICAL LEVELS, I.E. TO CONDITIONS ON WHICH EX-IM BANK AND CANADIAN EXPORT DEVELOPMENT CORPORATION (EDC) NOW OPERATE. SHOWMAN SAID JOHN MACDONALD, PRESIDENT OF EDC HAD MET WITH EX-IM PRESIDENT DUBRUL IN WASHINGTON RECENTLY AND THEIR VIEWS APPEARED TO COINCIDE. HE EXPRESSED HOPE THAT U.S. AND CANADA COULD REFLECT THIS COMMON LINE AT APRIL 19-20 MEETING OF OECD EXPORT CREDITS GROUP.

6. COHEN SAID MACDONALD WOULD BE PREPARED TO DISCUSS TAX TREATY NEGOTIATIONS WITH FOCUS ON DIVIDEND WITHHOLDING TAX PROVISION, WHICH, ACCORDING TO COHEN, IS CHIEF STUMBLING BLOCK TO CONCLUDING TREATY. COHEN SAID THAT ASIDE FROM REVENUE CONSIDERATIONS FOR CANADA, WHICH WERE CONSIDERABLE, GOC WOULD BE UNDER GREAT PRESSURE TO RENEGOTIATE TAX TREATIES WITH EUROPEAN COUNTRIES IF GOC ACCEDED TO U.S. DESIRE TO LOWER WITHHOLDING TAX RATE

BELOW 15 PERCENT.

7. ACCORDING TO COHEN, MACDONALD IS UNDER CONSIDERABLE PRESSURE TO RAISE ISSUE OF NEW U.S. TAX LEGISLATION REGARDING CONVENTIONS OUTSIDE U.S. ALTHOUGH GOC AGREED "IN PRINCIPLE" WITH GENERAL THRUST OF LEGISLATION (AND CANADA'S OWN TAX RULES REFLECT THIS ATTITUDE), MACDONALD WOULD PROBABLY EXPRESS CONCERN ABOUT THREE ASPECTS: (A) SPECIFIC DISCRIMINATION AGAINST FOREIGN LOCATIONS (GOC MAKES DISTINCTION ON BASIS GEOGRAPHICAL SCOPE OF ORGANIZATION); (B) PER DIEM LIMITS (E.G. \$46 IN TORONTO IS "HIGHLY UNREALISTIC" IN LIGHT ACTUAL HOTEL AND FOOD

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PAGE 01 OTTAWA 01264 02 OF 02 040151Z
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LIMITED OFFICIAL USE SECTION 02 OF 02 OTTAWA 01264

COSTS); AND (C) COUNTING ATTENDANCE AT SUB-COMMITTEE OR WORKING GROUP MEETINGS SAME AS ACTUAL CONVENTIONS, I.E. AS ONE OF TWO CONVENTIONS ALLOWED EACH YEAR (THIS CREATES PROBLEMS FOR ACTIVELY INVOLVED MEMBERS OF MANY U.S./ CANADIAN ORGANIZATIONS).

8. WHEN SHOYAMA JOINED GROUP, CONVERSATION SHIFTED TO GENERAL INTERNATIONAL ECONOMIC SPHERE. SHOYAMA SAID MACDONALD WILL BE INTERESTED IN OBTAINING RECENT U.S. VIEWS ON IDA REPLENISHMENT, ODA, OECD FINANCIAL SUPPORT FUND, AND IMF ISSUES. (MACDONALD WILL BE MEETING WITH

IMF OFFICIALS IN WASHINGTON IMMEDIATELY BEFORE HIS DISCUSSIONS WITH BLUMENTHAL). ECON COUNSELOR LEFT WITH SHOYAMA COPY OF TEXT OF ASSISTANT SECRETARY BERGSTEN'S FEBRUARY 10 TESTIMONY BEFORE SENATE APPROPRIATION COMMITTEE ON U.S. CONTRIBUTIONS TO INTERNATIONAL FINANCIAL INSTITUTIONS. JOYCE SAID HE UNDERSTOOD U.S. MAY FAVOR CHANNELING LESS OF IDA'S RESOURCES TO INDIA AND MORE LIMITED OFFICIAL USE

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PAGE 02 OTTAWA 01264 02 OF 02 040151Z

TO COUNTRIES SUCH AS EGYPT; HE SAID MACDONALD WOULD BE INTERESTED IN HEARING ABOUT THIS.

9. SHOYAMA SAID MACDONALD, BECAUSE OF HIS PREVIOUS POSITION AS MINISTER OF ENERGY, MINES AND RESOURCES, WOULD BE INTERESTED IN U.S. VIEWS ON ENERGY MATTERS. HE MENTIONED IN PARTICULAR PIPELINE ISSUES AND POSSIBILITY THAT JOINT GAS PIPELINE MIGHT REQUIRE COORDINATED APPROACH TO FINANCIAL GUARANTEES.

10. IN ANSWER TO QUESTIONS ABOUT STATE OF CANADIAN ECONOMY, DROP IN EXCHANGE VALUE, MACDONALD'S SPRING BUDGET AND LIFTING OF CONTROLS - ALL OF WHICH ECON COUNSELOR SAID WOULD BE ON MINDS OF WASHINGTON PARTICIPANTS IN DISCUSSIONS WITH MACDONALD - SHOYAMA ACKNOWLEDGED THAT SLUGGISH ECONOMY, AS EVIDENCED BY DROP IN REAL GNP IN 1976 FOURTH QUARTER, PRESENTED MACDONALD WITH VERY DIFFICULT PROBLEMS IN PREPARING SPRING BUDGET. HOWEVER, RECENT DROP IN EXCHANGE RATE OF CANADIAN DOLLAR, MAKING CANADIAN GOODS MORE COMPETITIVE, SHOULD GIVE BOOST TO EXPORT INDUSTRIES AND ALLOW GOC TO ADOPT LESS STIMULATIVE MEASURES IN SPRING BUDGET THAN WOULD OTHERWISE BE THE CASE. SHOYAMA GAVE IMPRESSION GOC IS WORKING ON ASSUMPTION CANADIAN DOLLAR WILL REMAIN AT OR BELOW PRESENT LEVEL FOR SOME TIME. HE CITED LOWER FOREIGN BORROWINGS AND POLITICAL UNCERTAINTIES AS FACTORS IN THIS SITUATION.

11. SHOYAMA SAID UNEMPLOYMENT, PARTICULARLY IN QUEBEC AND MARITIME PROVINCES, WAS BECOMING MORE TROUBLESOME AND THEREFORE SPRING BUDGET WOULD ADDRESS THIS PROBLEM TO GREATER EXTENT THAN JOBS CREATION PROGRAM ANNOUNCED LAST NOVEMBER.

12. TO SURPRISE OF FINANCE OFFICIALS, SHOYAMA SAID, CANADIAN PUBLIC APPEARS MORE SATISFIED WITH CONTROLS

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PAGE 03 OTTAWA 01264 02 OF 02 040151Z

PROGRAM THAN EXPECTED. ACCORDING THEIR LATEST SURVEY AND FROM MEETINGS WITH VARIOUS SECTORS OF POPULATION, FINANCE DEPARTMENT HAS FOUND THAT CONTROLS WERE AS POPULAR NOW (MAJORITY SUPPORT) AS WHEN INSTITUTED, ALTHOUGH BUSINESS REMAINED AMBIVALENT. THEREFORE, SHOYAMA STATED, THERE IS MUCH LESS PRESSURE TO REMOVE CONTROLS IN IMMEDIATE FUTURE, AND HE LEFT IMPRESSION THAT CONTROLS WOULD CONTINUE THROUGH 1977.

13. SHOYAMA SAID GOC WOULD PREFER MODERATE BUT SUSTAINED GROWTH IN U.S. IN 1977 TO TYPE OF GROWTH EXPERIENCE OF 1976 WHEN U.S. GROWTH SPURTED IN FIRST QUARTER AND THEN TAPERED OFF. SPURT IN U.S. ECONOMY CAUSED LARGE INVENTORY ACCUMULATION IN CANADA IN ANTICIPATION OF MUCH GREATER DEMAND, AND WHEN GROWTH IN U.S. SLACKENED, THESE LARGE CANADIAN INVENTORIES HAD TO BE WORKED OFF THUS CAUSING DROP IN CANADIAN PRODUCTION.

14. SHOYAMA LEFT STRONG IMPRESSION THAT SPRING BUDGET WILL HAVE FEW STIMULATIVE MEASURES ("WE ALREADY HAVE BUILT-IN ECONOMIC STABILIZERS SUCH AS INDEXING OF INCOME TAXES") BUT WILL CONCENTRATE ON JOB CREATION. CANADA WILL BE LOOKING TO U.S. IN PARTICULAR BUT ALSO JAPAN AND GERMANY FOR SPILL-OVER EFFECTS OF THEIR EFFORTS TO REVITALIZE WORLD ECONOMY. "YOU ARE THE TAIL WAGGING THIS DOG," SAID SHOYAMA. LEARY

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